

The Regents of the University of California

COMMITTEE ON AUDIT

March 18, 1999

A Special Meeting of the Committee on Audit was held on the above date at UCSF-Laurel Heights, San Francisco.

Members present: Regents Connerly, Davies, Khachigian, Lee, Parsky, and Sayles

In attendance: Regents Atkinson, Bagley, Bustamante, Eastin, Hopkinson, Johnson, Kozberg, Lansing, Leach, Miura, Montoya, Nakashima, Preuss, and Willmon, Regents-designate Pannor, Taylor, and Vining, Faculty Representative Dorr, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gurtner, and Hopper, Chancellors Berdahl, Bishop, Cicerone, Orbach, and Yang, University Auditor Reed, and Recording Secretary Nietfeld

The meeting convened at 10:50 a.m. with Committee Chair Sayles presiding.

APPROVAL OF EXTERNAL AUDIT PLAN FOR THE YEAR ENDING JUNE 30, 1999

The President recommended that the annual external audit plan for the year ending June 30, 1999 be approved.

[The annual audit plan was mailed to all Regents in advance of the meeting, and a copy is on file in the Office of the Secretary.]

The Committee was informed that the annual external audit plan provides for a financial audit of the University of California and the University of California Retirement System. Additional audit coverage by the external auditor includes the National Collegiate Athletic Association audit, the Revenue Bond Indentures audit, an audit of the individual medical centers, and the Federal Grants and Contracts audits. At the November 1998 meeting, The Regents approved the reappointment of Deloitte & Touche LLP as external auditor for the fiscal year ending June 30, 1999.

Mr. Rich Fineberg, managing partner for Deloitte & Touche, informed the Committee that the University of California is Deloitte & Touche's flagship client nationwide in its university practice. In addition, the University of California is considered to be "strategic," as are such firms as General Motors, Dow Chemical, and Microsoft.

Mr. Fineberg reported that last year the New York Stock Exchange and the National Association of Securities Dealers commissioned a blue ribbon panel to study the work of audit committees, particularly those of publicly held corporations. The purpose of the commission was to strengthen the role of audit committees in the oversight of the financial reporting process. He stated his intention to send to the Regents a booklet that spells out in detail what changes are recommended in the report.

It is expected that Deloitte & Touche will discuss the report with the Committee at the May meeting. Committee Chair Sayles asked that the discussion focus on the report's application to the University.

Mr. Bob Schapperle, lead client service partner, noted that the scope and timing of the 1999 audit are consistent with prior years. The audit has been tailored to focus on key areas of audit risk, specifically the risk of financial statement misstatement. The plan anticipates completion of the audit on or about September 17, which will provide Deloitte & Touche the opportunity to review the audit with the Committee at its November meeting. The firm will spend 25,000 to 26,000 hours on the engagement and will have fifty managers, partners, and senior accountants leading the audit effort.

Deloitte & Touche has identified a number of areas of focus for the audit, the first two of which are new for 1999.

Construction Expenditures: The University of California has significant construction project expenditures either planned or under way. The audit will include consideration of internal controls affecting expenditures arising from each phase of the process and the extent and nature of the amounts capitalized.

Technology Transfer: The auditors will focus on understanding the process for billing, recording, and collecting revenues.

Business Systems: As in prior years, Deloitte & Touche will focus on any effects on the control structure resulting from significant systems conversions or modifications.

Year 2000: The auditors will update their understanding of the activity under way that affects financial systems as well as progress in remediating mission-critical systems. Deloitte & Touche understands that Internal Audit will perform a systemwide audit program to review, test, and report on management's progress. As in the past, Deloitte & Touche will not provide any assurances or express any opinion on the University's systems.

Self-Insurance Liabilities: Deloitte & Touche will focus its efforts on identifying and understanding the controls surrounding the claim to payment process for the University's self-insurance program.

Treasury Function: As the University has over \$50 billion in investments under management, certain aspects of the University's Treasury activities are an area of audit focus. As part of this focus, the auditors will involve its financial services specialists in understanding the University's process for managing and valuing its securities. In addition, there will be a review of policies and procedures for managing the University's "derivative" exposure to ensure compliance with University hedging guidelines.

Mr. Jack Krouskup, client service partner for the medical centers, reported that, consistent with past years, the audit of the medical centers will focus heavily on the control environment, with a significant concentration on high-risk areas. The areas of focus will include managed care contracting, physician billing, and third-party reimbursements. In each of these areas, Deloitte & Touche will review and

test management's processes and evaluations and the related documentation. Secondly, corporate compliance continues to be an important focus of the Universitywide compliance committee. As a part of the 1999 audit, Deloitte & Touche will update its understanding of the status of the professional fee billing guidelines and the corporate compliance guidelines for the health services clinical enterprise. Activities in this area will include discussions regarding campus-specific plans and the related monitoring processes. Mr. Krouskup recalled that at the November 1998 meeting Deloitte & Touche discussed the areas of clinical enterprise reporting and compliance activities. The external auditors have recently performed limited procedures for the six-month period ended December 31, 1998 at each of the four medical centers, which included discussions with management regarding progress related to these two management-letter observations from 1998. Based on these discussions, Deloitte & Touche believes that management is giving attention to these matters. In the course of the 1999 audit, Deloitte & Touche will update its understanding of these matters and report to the Committee in the fall.

Mr. Schapperle referred to the new disclosure requirement that results from a recent pronouncement of the Governmental Accounting Standards Board (GASB) which requires disclosure in the footnotes to the financial statements of the University's Year 2000 remediation efforts. On March 2, 1999 the GASB issued a technical bulletin exposure draft which, if adopted, will modify the previously issued technical bulletin to allow the University to exclude the required disclosure from the footnotes if it is included as supplementary information to the financial statements. If the exposure draft is adopted as expected, the University will include the required discussion as supplementary information to its June 30, 1999 financial statements. If presented as supplementary information, it will be outside the audit, and Deloitte & Touche's procedures will be limited to reading it and, if required by professional standards, inquiring about the preparation of the information, the methods used for measurement, as well as compliance with GASB guidelines. As a result, subject to the successful completion of the audit, Deloitte & Touche anticipates that its report on the June 30, 1999 financial statements would be unqualified and would either not refer to the supplementary information or would include a separate paragraph with the following language:

The status of the University's Year 2000 remediation plans on page X is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Mr. Schapperle continued that Deloitte & Touche is committed to a plan of continuous communication. It plans to identify issues early and resolve them as soon as possible. To this end, Deloitte & Touche will conduct an interim audit phase during April and May at each of the campuses and medical centers. Further, the auditors engage in ongoing conversations with management throughout the year. Deloitte & Touche intends to issue three management letters, one to The Regents, one to the Chancellors, and one to the Vice Chancellors of Finance and Administration. This approach should streamline the communication process and also provide an opportunity for more

value-added business advice. While none is anticipated, Deloitte & Touche will report any material weaknesses in the University's control structure to the Committee on Audit, as well as any other matters which warrant the attention of the Regents, including matters reported at the chancellorial level that have applicability across the system. This approach should provide the Regents with more useful and concise information and provide the campuses and medical centers with helpful advice, observations, and recommendations.

In response to a comment by Regent Lee regarding staffing, Mr. Schapperle explained that the managers listed on Deloitte & Touche's organization chart lead a team of over one hundred staff professionals in carrying out The Regents' audit.

Regent Lee inquired about Deloitte & Touche's relationship with the University's Internal Audit Department. Committee Chair Sayles observed that there is close coordination between The Regents' external and internal auditors. University Auditor Reed added that he and Mr. Schapperle meet annually to look for areas where the two teams can work together. Deloitte & Touche also examines the University's internal audit plan.

In response to Regent Lee's comment regarding staffing, Regent Sayles observed that an effort is being made to build continuity for the account. At the director level, the auditors have been with the University's account for several years.

Faculty Representative Dorr noted that UCSF Stanford is not included in the external audit plan and asked what provisions are being made for an audit of UCSF Stanford. Regent Leach, who is a member of the UCSF Stanford Board of Directors, responded that the Board had selected Arthur Andersen to perform its audit. He added that the Board of UCSF Stanford would be happy to share any information that the Regents would require. He commented that the University of California has been receiving a high-quality audit since the account was awarded to Deloitte & Touche.

In response to a question from Regent Connerly regarding the scope of the audit on construction activities, Mr. Schapperle reported that Deloitte & Touche will be looking at the controls that are in place to assemble the information for capitalization purposes and to control the expenditure of funds. This audit will be performed at each campus and medical center with major construction activity. The auditors will read contracts with the construction companies and the architects and engineers as background to the audit but will not be involved in any project until it has been authorized by the Board.

Committee Chair Sayles expressed the Regents' gratitude to Deloitte & Touche for the quality of the audits performed.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

The meeting adjourned at 11:15 a.m.

Attest:

AUDIT

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March 18, 1999

Secretary